



NORTH CAROLINA LAW REVIEW

Volume 58 | Number 4

Article 7

4-1-1980

Chapter 13's Potential for Abuse

Robert L. Hughes

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Robert L. Hughes, *Chapter 13's Potential for Abuse*, 58 N.C. L. REV. 831 (1980).

Available at: <http://scholarship.law.unc.edu/nclr/vol58/iss4/7>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

CHAPTER 13's POTENTIAL FOR ABUSE

THE HONORABLE ROBERT L. HUGHES†

Chapter 13 of the Bankruptcy Reform Act of 1978 is entitled "Adjustment of Debts of an Individual with Regular Income."¹ Its immediate predecessor was Chapter VI of the legislation proposed in 1973 by the Commission on the Bankruptcy Laws of the United States,² which was called "Plans for Debtors with Regular Income." Both chapters were patterned after Chapter XIII of the 1938 Chandler Act, an amendment to the Bankruptcy Act of 1898; Chapter XIII was known as "Wage Earners' Plans."³

This Article examines the distinctive features of this form of relief and the efforts of both the Commission and the Congress to improve it. The Article concludes that Congress, in its effort to encourage greater use of payment plans in general by making partial payment plans in particular more attractive to consumer debtors, inadvertently has made Chapter 13 susceptible to abuse by debtors. Only Congress is capable of reducing this potential for abuse while preserving the attractive features of payment plans. In the meantime, the courts are responsible for construing Chapter 13 in a way that furthers, rather than frustrates, legislative objectives.

I. DISTINCTIVE FEATURES

The major characteristic of the system of payment plans established by Chapter 13 is the payment to creditors from the debtor's future income as an alternative to ordinary bankruptcy, which subjects the debtor's nonexempt property to liquidation.⁴ Although, Chapter 13 payment plans differ from the relief available under Chapters 7 and through 11 in other ways—for instance, Chapter 13 is restricted to individuals;⁵ corporations and partnerships are excluded—nothing distin-

† Bankruptcy Judge, United States District Court for the Northern District of California. B.A. 1948, University of California at Berkeley; J.D. 1957, Hastings College of Law.

1. 11 U.S.C.A. §§ 1301-1330 (West 1979).

2. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pts. I & II (1973), *reprinted in* COLLIER ON BANKRUPTCY, app. 2 (15th ed. 1979) [hereinafter cited as COMM'N REP., pt. I or pt. II].

3. *See* Chandler Act, ch. 575, §§ 601-686, 52 Stat. 840 (1938).

4. 11 U.S.C.A. §§ 701-766 (West 1979).

5. 11 U.S.C.A. § 109(e) (West 1979); 11 U.S.C. §§ 1021, 1006(3) (1976) (repealed 1978).

guishes this form of bankruptcy relief from ordinary or straight bankruptcy,⁶ or from business workout or reorganization chapters⁷ so much as the dedication of future income to the debtor's creditors.⁸

Dedication of the debtor's future income is significant because, as a matter of bankruptcy law, creditors have no claim to the future income of individuals. Post-bankruptcy earnings form no part of the estate that is administered for the benefit of creditors.⁹ This contrast—payment of creditors' claims in full or in part from an asset that is beyond the bankruptcy trustee's reach—entitles payment plans to great deference. It also defines the proper extent of that deference and explains why payment plans are strictly voluntary with the debtor.¹⁰

Payment plans based on future income afford the debtor two basic advantages over straight bankruptcy.¹¹ First, liquidation of nonexempt assets may be avoided.¹² Second, the debtor is protected from harassment while meeting his obligations and avoiding the stigma of bank-

6. 11 U.S.C.A. §§ 701-766 (West 1979). Under the Bankruptcy Act of 1898, ordinary or straight bankruptcy relief was afforded by the first seven chapters taken together. See 11 U.S.C. §§ 1-112 (1976) (repealed 1978).

7. 11 U.S.C.A. §§ 1101-1174 (West 1979); see 11 U.S.C. §§ 501-676, 701-799, 801-926 (1976) (repealed 1978).

8. See 11 U.S.C.A. § 1322(a)(1) (West 1979), which requires that the plan "provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." See also 11 U.S.C. §§ 1012, 1046(4) (1976) (repealed 1978); COMM'N REP., *supra* note 2, pt. II, § 6-201, at 204.

9. 11 U.S.C.A. § 541(a)(6) (West 1979) excludes from property of the estate "earnings from services performed by an individual debtor after the commencement of the case."

10. *Rice v. Mimms*, 291 F.2d 823, 824-25 (10th Cir. 1961); *McKeever v. Local Finance Co.*, 80 F.2d 449, 452 (5th Cir. 1935) (debtor's payment plan based on future earnings confirmed under 11 U.S.C.A. § 74 (1976) (repealed 1978), a forerunner of Chapter XIII).

The Bankruptcy Commission considered but rejected involuntary payment plans. COMM'N REP., *supra* note 2, pt. I, at 158-59. The Congress also considered and rejected involuntary payment plans in 1967. *Hearings on H.R. 1057 & H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Cong., 1st Sess. (1967); see note 38 *infra*.

11. There can be other advantages that are not inherent in payment plans. For instance, cram down gives the debtor considerable leverage in effecting redemption of nonexempt collateral by installments. See 11 U.S.C.A. § 1325(a)(5)(B) (West 1979). Likewise, the debtor can effect installment payments of nondischargeable taxes to the Internal Revenue Service by use of *id.* § 1322(a)(2). A further example is the ability to cure delinquencies on home mortgages (while staying foreclosure) provided by *id.* § 1322(b)(3), which allows "the curing or waiving of any default." Congress could write each of these advantages into Chapter 7 bankruptcy without invoking the mechanism of payment plans; therefore these advantages do not illustrate fundamental differences between payment plans and ordinary bankruptcy. The same may be said about differences based on the principles of discharge and dischargeability. See notes 84 & 86 and accompanying text *infra*.

12. "The benefit to the debtor of developing a plan of repayment under Chapter 13, rather than opting for liquidation under Chapter 7, is that it permits the debtor to protect his assets. In a liquidation case, the debtor must surrender his nonexempt assets for liquidation and sale by the trustee." H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 118 (1977), reprinted in COLLIER ON BANKRUPTCY, app. 2 (15th ed. 1979) [hereinafter cited as HOUSE REP.].

ruptcy.¹³ The second of these two advantages assumed by far the greater practical importance under Chapter XIII of the Act, and was widely acclaimed.¹⁴

Concerning the first advantage, a payment plan can substitute for straight bankruptcy by paying creditors no more than the value of the debtor's nonexempt property. Such a plan is justifiable as a matter of public policy. Every legitimate objective of bankruptcy is served by permitting the debtor to preserve in kind assets that would otherwise be liquidated in bankruptcy so long as creditors receive from the debtor's future income whatever they would have received in liquidation. Accordingly, payment plan legislation under the old Act and the current Code requires as a minimum condition of confirmation and of discharge that the plan assure to creditors no less than what they would have received had the debtor received a discharge in ordinary bankruptcy.¹⁵

Conversely, if creditors receive no more under a payment plan than they would receive in ordinary bankruptcy, no policy is served by making payment plans more attractive to debtors than ordinary bankruptcy. Indeed, just the opposite is true because of the underlying premise for encouraging payment plans—namely, that creditors have no claim to the debtor's future income. Creditors do have an interest in the debtor's future income in ordinary bankruptcy if the debtor is denied a discharge or, should discharge be granted, if the creditor is owed a nondischargeable debt. Thus, any relaxation of the bar to discharge or to dischargeability of a particular debt in a payment plan that proposes no more than liquidation value deprives creditors of rights they

13. "In addition, it satisfies many debtors' desire to avoid the stigma attached to straight bankruptcy and to retain the pride attendant on being able to meet one's obligations." *Id.*

14. "The hearing record and the bankruptcy literature show uniform support for [Chapter XIII whereby an individual may] pay his debts and avoid bankruptcy by making periodic payments to a trustee under bankruptcy court protection . . ." S. REP. NO. 95-989, 95th Cong., 2d Sess. 12 (1978), reprinted in COLLIER ON BANKRUPTCY, *supra* note 2, app. 3 [hereinafter cited as SENATE REP.]. "No feature of the present Bankruptcy Act has received as much general acclaim as Chapter XIII, entitled Wage Earners' Plans." COMM'N REP., *supra* note 2, pt. I at 157.

15. 11 U.S.C.A. § 1325(a)(4) (West 1979), requires a finding that "the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7 of this title on such date." A similar provision in the Bankruptcy Act of 1898 was § 766(2), which stated that the court should confirm an arrangement if satisfied that "[i]t is for the best interests of the creditors . . ." The Second Circuit defined best interests as not less than what would be paid on liquidation. *Technical Color & Chem. Works v. Two Guys from Massapequa*, 327 F.2d 737, 741 (2d Cir. 1964) (citing 9 COLLIER ON BANKRUPTCY 280 (14th ed. 1963)).

have in ordinary bankruptcy while serving no useful purpose in exchange.

Payment plans in excess of liquidation value—that is, in excess of what creditors would receive in ordinary bankruptcy—are highly desirable from the standpoint of creditors' self interest as well as that of debtors' self esteem and are, therefore, deserving of encouragement. Most deserving, of course, are plans that result in full payment to creditors, and plans that pay 70 percent of claims are more deserving than those paying 35 percent.

Under Chapter XIII between 1938 and 1979, full payment plans were encouraged as an alternative to ordinary bankruptcy by three factors: (1) the desire of many debtors to pay their debts;¹⁶ (2) the existence of nondischargeable debt;¹⁷ and (3) since 1966, the possibility of obtaining a discharge despite the existence of a prior discharge in bankruptcy or partial payment (composition) plan within the preceding six years.¹⁸ In 1966 the Supreme Court recognized the great difference between a full payment plan, which it held could be confirmed despite the prior discharge in bankruptcy or composition, and a partial payment plan, which it held could not be confirmed under the same circumstances.¹⁹

Partial payment plans, on the other hand, were encouraged under Chapter XIII only by the debtor's desire to pay creditors as much as possible, or to preserve nonexempt assets in kind. In two major respects, partial payment plans were significantly less attractive to debtors than full payment plans. First, whether the debtor proposed to pay

16. "The hearings before the Subcommittee indicated strongly that most consumer debtors would rather work out a repayment plan than file straight bankruptcy." HOUSE REP., *supra* note 12, at 117.

"The Commission was frequently informed by witnesses at its hearings and in correspondence that the preponderant majority of debtors desire some means of paying their debts in preference to incurring the stigma and other consequences of bankruptcy." COMM'N REP., *supra* note 2, pt. I, at 157.

17. Debts not dischargeable under § 17(a) of the Bankruptcy Act were dischargeable under a Chapter XIII plan if the creditors holding those debts accepted the plan. 11 U.S.C. § 1060 (1976) (repealed 1978).

18. Section 14c(5) barred discharge in ordinary bankruptcy if the debtor "in a proceeding under this title commenced within six years prior to the date of the filing of the petition in bankruptcy had been granted a discharge, or had a composition or an arrangement by way of a composition or a wage earner's plan by way of composition confirmed under this title." 11 U.S.C. § 32(c)(5) (1976) (repealed 1978). Section 656(a)(3) incorporated § 14c as a bar to confirmation of Chapter XIII plans. 11 U.S.C. § 1056(a)(3) (1976) (repealed 1978). In *Perry v. Commerce Loan Co.*, 383 U.S. 392 (1966), the Court held, however, that § 14c(5), as incorporated into § 656(a)(3), barred confirmation only of partial payment plans and not of plans proposing full payment.

19. *Perry v. Commerce Loan Co.*, 383 U.S. 392 (1966).

creditors liquidation value or more than liquidation value, the plan could not be confirmed if, within the previous six years, the debtor had received a discharge in ordinary bankruptcy or had had a partial payment plan confirmed.²⁰ Second, if the plan were confirmed, the debts that would be excepted from discharge in ordinary bankruptcy would remain nondischargeable after completion of the plan.²¹

Those who have studied the bankruptcy system in recent years have been concerned about the great number of consumer bankruptcies and have been favorably impressed with the alternative to straight bankruptcy afforded by Chapter XIII plans providing for payment from future income.²² These studies disclosed, however, that Chapter XIII was not uniformly accepted throughout the United States.²³ They also found that the vast majority of plans proposed by debtors under Chapter XIII were full-payment extensions rather than partial-payment compositions.²⁴ The Commission initially, and Congress thereafter, decided to encourage greater use of plans for payment out of future income as an alternative to straight bankruptcy.²⁵

II. POTENTIAL FOR ABUSE

Although Chapter 13, the payment plan statute enacted as part of the Bankruptcy Reform Act of 1978, includes several features that make payment plans more attractive to debtors and their attorneys, the statute falls short as model legislation because of its potential for abuse. Four factors contribute to this unsatisfactory condition. Chapter 13 as enacted (1) denies unsecured creditors a vote on the debtor's plan;²⁶ (2)

20. See note 18 *supra*.

21. Bankruptcy Act §§ 660, 661, 11 U.S.C. §§ 1060, 1061 (1976) (repealed 1978).

22. See, e.g., D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 105 (1971) ("Compared to straight bankruptcy, the Chapter XIII process is simple and effective."). See also COMM'N REP., *supra* note 2, pt. I at 157.

23. D. STANLEY & M. GIRTH, *supra* note 22, at 74-76; COMM'N REP., *supra* note 2, pt. I at 12, 157-58.

24. D. STANLEY & M. GIRTH, *supra* note 22, at 94 ("Compositions were proposed in only 1 percent of the cases in the Chapter XIII sample."); see COMM'N REP., *supra* note 2, pt. I at 160-62.

25. "The Commission is convinced nevertheless that wage earner plans of the kind authorized by Chapter XIII of the present Act should be fostered. It sought to discover reasons why Chapter XIII has not been more popular and successful and has sought to discover ways and means of enhancing the effectiveness of this chapter without making it compulsory." COMM'N REP., *supra* note 2, pt. I at 159.

"The premises of the bill with respect to consumer bankruptcy are that use of the bankruptcy law should be a last resort; that if it is used, debtors should attempt repayment under Chapter 13." HOUSE REP., *supra* note 12, at 118.

26. This was recommended by the Bankruptcy Commission. COMM'N REP., *supra* note 2, pt.

establishes no standard of payment from future income;²⁷ (3) grants discharge of unpaid debt despite conduct that would bar discharge in ordinary bankruptcy;²⁸ and (4) abandons the principle of excepting certain debts from discharge,²⁹ again in contrast to ordinary bankruptcy. A few examples illustrate the potential for abuse created by these provisions.

Ex. 1. A debtor who has been granted a discharge within the previous six years and who has concealed property of the estate is ineligible for discharge in Chapter 7 ordinary bankruptcy on two separate grounds.³⁰ That debtor is eligible for discharge under the provisions of Chapter 13, however, even though only a nominal sum is paid to creditors.³¹

Ex. 2. A debtor who has embezzled or who has been fined for willfully evading taxes cannot discharge these liabilities even if a discharge is granted in Chapter 7 ordinary bankruptcy.³² These liabilities are dischargeable in Chapter 13, though, however little is paid to creditors.³³

Ex. 3. The statutory minimum payment to creditors in Chapter 13 is "not less than" the amount creditors would receive had the debtor filed for Chapter 7 ordinary bankruptcy.³⁴ This frequently is nothing. Theoretically, then, a debtor's plan could be confirmed even if no payments to creditors were proposed.

These conditions create only a potential for abuse because the courts retain the responsibility for construing legislation. But the statutory scheme gives the courts little leeway, and judicial efforts to prevent abuse and to give effect to congressional objectives can achieve only patchwork results at best.

To understand the roots of the problems created by Chapter 13

I at 162. For a discussion of the Commission's findings, see note 43 *infra*. See also notes 75-77 and accompanying text *infra*.

27. See notes 83 & 84 and accompanying text *infra*.

28. This was recommended by the Bankruptcy Commission. COMM'N REP., *supra* note 2, pt. I at 163. For a discussion of the Commission's findings, see notes 44 & 45 *infra*. See also notes 81-84 and accompanying text *infra*.

29. See notes 55-72 and accompanying text *infra*.

30. 11 U.S.C.A. § 727(a)(2), (a)(8) (West 1979).

31. *Id.* § 1328(a) provides for discharge "after completion by the debtor of all payments under the plan . . ." Neither *id.* § 1322(a), the provision governing mandatory contents of the plan nor § 1325(a), which governs confirmation of the plan, requires that creditors be paid more than the value of the debtor's nonexempt assets.

32. *Id.* § 523(a)(1).

33. *Id.* § 1328(a)(2) excepts only § 523(a)(5) family support obligations from discharge.

34. *Id.* § 1325(a)(4).

one must begin with a review of the work of the Bankruptcy Commission.

III. COMMISSION STRATEGY

In pursuing the objective of encouraging a shift of consumer debtors from ordinary bankruptcy to future income payment plans, the Bankruptcy Commission developed a strategy of enhancing the attractiveness of those plans in general³⁵ and of partial payment plans (compositions) in particular.³⁶ The Commission identified a number of obstacles to the greater use of payment plans. These included lack of protection for co-debtors of the principal debtor;³⁷ limitations on the power to deal with secured creditors,³⁸ notably those holding automobiles as collateral; and the inability of the courts to force payment plans on debtors.³⁹ The Commission also concluded that a major obstacle to the greater use of payment plans was the limited attractiveness of compositions to debtors.⁴⁰

The Commission recommended statutory protection for co-debtors⁴¹ and a series of provisions that would greatly increase the ability of

35. "The Commission concluded that an indispensable condition to any increase in the utilization of the opportunity to work out a plan to pay debts out of future income would be the establishment of a counseling program that would insure that every petitioner with a regular income would be informed of the availability of this kind of relief before choosing any remedy under the Act." COMM'N REP., *supra* note 2, pt. I at 172.

36. *See id.* at 172-74. Noting a relationship between "the limited use of present Chapter XIII" and "nonuse of the composition feature" of Chapter XIII, the Commission identified several reasons for the "general unpopularity of compositions" and concluded by recommending that "the proposed Act accommodate" the experience in those few districts in which Chapter XIII compositions have "been quite successful." *Id.*

37. "Not infrequently under the present Act the success of a Chapter XIII plan may be jeopardized by pressures exerted on the debtor by sureties on the debtor's obligations who have been compelled to pay by those creditors of the Chapter XIII debtor who are unwilling to await payments pursuant to the plan." *Id.* at 166-167.

38. "The chief difficulties and most of the litigated cases that have arisen under Chapter XIII involve the rights of secured creditors." *Id.* at 165.

39. "[P]roposals have been made to Congress from time to time that a debtor able to obtain relief under Chapter XIII should be denied relief in straight bankruptcy, and the Commission has received communications expressing support for a change in the Bankruptcy Act to this effect." *Id.* at 158. The Commission rejected the principle of "conditioning the availability of bankruptcy relief, including discharge, on a showing by the debtor that he cannot obtain adequate relief from his condition of financial distress by proposing a plan for payment of his debts out of his future earnings" for the same reason that the Congress rejected this principle in 1967—the unlikelihood of success. *Id.* at 159. *See also* note 10 *supra*.

40. "[T]he fact that the confirmation of a wage-earner's composition has barred a subsequent discharge for six years in the same way as has a prior discharge in bankruptcy has discouraged utilization of the composition feature in Chapter XIII." *Id.* at 11.

41. COMM'N REP., *supra* note 2, pt. II, at 214 (proposed § 6-208, *Collections from Codebtors*).

debtors to deal with secured creditors.⁴² More importantly, the Commission recommended three other changes in the existing law that would enhance the attractiveness of partial payment plans. First, its bill eliminated creditor participation in accepting or rejecting the debtor's plan.⁴³ Second, it removed the distinction between full payment and partial payment plans based on prior bankruptcies or prior composition plans within six years.⁴⁴ Third, it recommended that confirmation of either a full payment or partial payment plan no longer be refused because of conduct, aside from overuse of the bankruptcy system, that would bar a discharge in bankruptcy.⁴⁵

42. *Id.* at 204-05 (proposed § 6-201(2)-(4) and accompanying notes).

43. "[A]cceptance [of the debtor's plan] by creditors is no longer a prerequisite to confirmation." *Id.* at 207. See also *id.* at 208 n.1. The Commission's rationale for eliminating creditor acceptance of plans is somewhat uncertain but it seems to have been simply that partial payment plans were more likely to be rejected by creditors. See *id.* pt. I at 161.

On the other hand, the Commission received information that "it is unusual for more than a very few creditors to qualify to vote by filing claims." *Id.* at 162. The Commission noted that:

The experience with compositions in the District of Maine and the Eastern District of Michigan is that unsecured creditors do not often object to proposed plans of composition. This result is not surprising in view of the fact that ordinarily the alternative is for the debtor to file a petition in bankruptcy and obtain a discharge notwithstanding the failure of the assets to yield enough proceeds to permit any distribution to creditors. The requirement of consent by a majority of creditors as a condition precedent to the confirmation of a proposal to pay debts out of future income of the debtor does not appear to the Commission to be a sufficient safeguard of their interests to warrant its retention and accordingly recommends its elimination.

The Commission concluded that

an independent determination that statutory standards have been met is the best assurance of the protection of creditors' interests. These standards include a determination that:

- (1) the provisions of this chapter have been complied with;
- (2) it is for the best interests of the creditors and is feasible; . . . and
- (3) the proposal . . . [is] in good faith

Id.

44. *Id.* pt. II, § 6-204(b) & n.4, at 207-08. See also *id.* § 4-505(7), the mirror provision in ordinary bankruptcy. A prior confirmation of a partial payment plan within five years was not a bar to discharge in the Commission Bill. Compare 11 U.S.C. § 32(c)(5) (1976) (repealed 1978) (discharge granted or composition confirmed within six years as a bar to discharge) with 11 U.S.C.A. § 727(a)(9) (West 1979) (discharge within six years as a bar to discharge, unless certain conditions met).

Two of the seven Commission recommendations with respect to payment plans were:

"(2) Relief by way of composition as well as extension be available despite the debtor's having obtained a discharge or confirmation of a composition within the previous five-year period.

(3) The confirmation of a composition not be a limitation on future relief under the Act." COMM'N REP., *supra* note 2, pt. I at 13.

These recommendations were in response to the "reason most frequently given" for "nonuse of" partial payment plans under Chapter XIII. *Id.* at 160-61. See also note 40 *supra*.

45. The subdivision also eliminates the provision in § 656(a)(3) of the present Act that a ground for a denial of discharge is also a ground for denial of confirmation of a plan. Neither the interests of the debtor nor those of his creditors are served by treating conduct which would bar a discharge under § 4-505 in a liquidation case as precluding the

These three changes removed all practical as well as statutory distinctions between partial payment plans and full payment plans with one major exception: liabilities that did not qualify for discharge in straight bankruptcy would remain after completion of a partial payment plan.⁴⁶ Otherwise, the distinctions between full payment plans and partial payment plans based on prior bankruptcies and compositions were abolished.⁴⁷

Removal of creditor voting on plans and of the bar to confirmation based on grounds that would deny discharge in bankruptcy, other than frequency of discharge, could be expected to enhance the attractiveness of both types of plans, but as a practical matter these changes were more important for partial payment plans. As pointed out by the Commission, creditors have little incentive to vote against full payment plans.⁴⁸

What the Commission did, however, was of less consequence than

debtor from attempting to pay off his debts, in whole or in part, under a Chapter VI plan. Certainly the creditors are better served by allowing him to make the attempt and the fact that he may have forfeited a discharge in a liquidation case may give the debtor a greater incentive to perform under the plan. While some conduct which might forfeit a discharge may also indicate that the debtor cannot be expected to perform under the plan, the administrator may take such conduct into account in ruling on the issue of feasibility. In eliminating grounds for denying discharge as bars to confirmation, this section conforms to § 7-310 of Chapter VII.

COMM'N REP., *supra* note 2, pt. II, § 6-204 & n.4, at 207-09.

The Commission also stated:

If the plan is 'in the best interests of the creditors' and has been proposed in 'good faith,' the fact that the debtor may not be eligible for a discharge in straight bankruptcy should not prevent confirmation of a plan of payment from future earnings, and the Commission accordingly recommends omission of any such limitation.

Id., pt. I at 163.

At one point in its report, the Commission conditioned this recommendation on creditor consent to the plan, which was later rejected by the Commission:

The Commission is of the opinion that neither the interests of the creditors nor the principles of sound bankruptcy administration require a denial of confirmation due to conduct on the part of the debtor which would bar a discharge. If the debtor wants to pay his debts pursuant to a plan, *and if the creditors are willing to go along*, he should be allowed to do so. The fact that a discharge would not be available in a liquidation case should furnish a greater incentive for the debtor to perform under the plan. Refusal to obey proper orders can be dealt with by the contempt power or refusal to confirm on the basis that the plan is not feasible.

Id. at 175 (emphasis added); *see* note 43 *supra*.

Furthermore, this was not even one of the Commission's seven major recommendations with respect to payment plans. *See id.* at 13. The seven major recommendations did, however, include removal of one of the grounds for denying discharge as a ground for barring confirmation of a plan. *See* note 44 *supra*.

46. Section 6-207(b) expressly made the provision excepting specific debts from discharge in ordinary bankruptcy applicable to payment plans. *See* COMM'N REP., *supra* note 2, pt. II, § 6-207(b) at 212.

47. *See* notes 44 & 45 *supra*.

48. COMM'N REP., *supra* note 2, pt. I at 161.

what it did not do: it failed to distinguish between partial payment plans that give creditors no more than they would receive in ordinary bankruptcy and partial payment plans that provide creditors more than would ordinary bankruptcy. In seeking to encourage both partial and full payment plans, the Commission overlooked that partial payment plans may range from 1 percent to 99 percent. Then, by fixing the minimum payment at no less than what creditors would receive in ordinary bankruptcy,⁴⁹ it authorized nonpayment plans that, taken at face value, were entitled to all the advantages of full payment plans save one: non-dischargeable debts survived the plan.

IV. CONGRESSIONAL OBJECTIVE

In enacting Chapter 13 of the Bankruptcy Code, Congress accepted the Bankruptcy Commission's proposals—in particular its choice of partial payment plans as a major means of promoting the Chapter's increased use—with two notable exceptions. First, the bar to discharge in ordinary bankruptcy based on a prior composition plan within six years was tightened.⁵⁰ Second, the policy of excepting certain debts from discharge pursuant to a composition was virtually abandoned.⁵¹ The form of the first exception indicates that Congress perceived a need that the Commission did not—namely, a statutory distinction between composition plans that are substantial and those that are merely nominal.⁵² The second departure from the Commission Bill, however, compounded the potential for abuse and served to frustrate the policy of encouraging substantial payments to creditors.⁵³

49. Section 6-204(b) required the plan be "in the best interests of . . . creditors" *Id.* pt. II, § 6-204(b), at 207; see note 15 and accompanying text *supra*.

50. The Commission Bill would have denied discharge if a payment plan had been confirmed within two years, but this bar did not apply "if the inability of the debtor to pay his debts is the result of causes not reasonably within his control and if payment of them from future income or other wealth will impose an undue hardship on the debtor and his dependents." COMM'N REP., *supra* note 2, pt. II, § 4-505(a)(7). The enacted provision is found in 11 U.S.C. § 727(a)(9) (West 1979), which is set out in note 54 *infra*.

51. See note 55 and accompanying text *infra*.

52. See note 54 and accompanying text *infra*.

53. The Senate Report accompanying S. 2266 stated: "As in current law, 100 per cent payment plans will be encouraged This kind of plan has provided great self-satisfaction and pride to those debtors who complete them and at the same time effect a maximum return to creditors." SENATE REP., *supra* note 14, at 13.

The House Report accompanying H.R. 8200 stated:

The purpose of Chapter 13 is to enable an individual, under court supervision and protection, to develop and perform under a plan for the repayment of his debts over an extended period. In some cases the plan will call for full repayment. In others, it may offer creditors a percentage of their claims in full settlement.

HOUSE REP., *supra* note 12, at 118. The House Report went on to state:

Evidence that Congress understood the need to distinguish between substantial partial payment plans and those that are merely nominal is found in section 727(a)(9)⁵⁴ of the Code. It provides that one who files bankruptcy under Chapter 7 within six years of a previously confirmed partial payment plan is ineligible for discharge unless the previous partial payment plan satisfied two separate conditions: (1) unsecured creditors received at least 70 percent on their claims, and (2) the partial payment represented the debtor's "best effort." Both of these conditions—one mathematically certain and therefore susceptible to uniform application, the other subjective and affected by community and personal values—provide an incentive to payment while encouraging greater use of substantial partial payment plans. Thus, section 727(a)(9) represents a strong expression of congressional policy favoring substantial partial payment plans.

Inexplicably, Congress did not distinguish between substantial and nominal partial payment plans in Chapter 13 itself, in defiance of symmetry and in contradiction of the apparent policy objective of encouraging substantial partial payment plans. Without either of the limitations—quantitative 70 percent or qualitative best effort—the express statutory scheme makes no distinction between plans proposing one cent on the dollar and those proposing full payment to creditors. The omission of a mirror provision to section 727(a)(9) in Chapter 13 is

Chapter 13 also protects a debtor's credit standing far better than a straight bankruptcy, because he is viewed by the credit industry as a better risk. In addition, it satisfies many debtors' desire to avoid the stigma attached to straight bankruptcy and to retain the pride attendant on being able to meet one's obligations. The benefit to creditors is self evident: their losses will be significantly less than if their debtors opt for straight bankruptcy.

Id.

54. 11 U.S.C.A. § 727(a)(9) (West 1979). This subsection bars discharge in Chapter 7 if "the debtor has been granted a discharge" in a partial payment (composition) case under Chapter 13 of the Code, *id.* § 1328, or under Chapter XIII of the Bankruptcy Act, 11 U.S.C. § 1060-1061 (1976) (repealed 1978)

commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B)(i) 70 percent of such claims; and

(C)(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort.

The Senate had sought in its version of § 727(a) to accomplish three objectives: (1) to "encourage 100 percent payment plans," (2) to "provide a slight brake on the wholesale filings of chapter 13's by small businessmen who wish to avoid some of the restrictions of chapter 11," and (3) "to prevent chapter 13 plans from turning into mere offers of composition plans under which payments would equal only the non-exempt assets of the debtor." SENATE REP., *supra* note 14, at 13.

The provision as enacted did not appear in either the Senate Bill (S. 2266) or the House Bill (H.R. 8200). It was instead adopted in the final stages of the legislative process.

not explained in the Committee Reports or in any of the recorded statements of the Committee chairmen. This suggests that Congress' failure to distinguish between substantial and nominal plans in Chapter 13 was not the result of a well-considered legislative decision, and may well have been unintentional.

Even less understandable is Congress' decision to make the exceptions to discharge virtually inapplicable under Chapter 13.⁵⁵ Simply put, section 1328(a)⁵⁶ discharges every kind of debt, except child and spousal support obligations, upon completion of a partial payment plan. While such a policy is at least debatable even when the partial payment is both substantial and the debtor's "best effort," it is controversial in the extreme if neither condition is present and the partial payment plan is little more than a Chapter 7 ordinary bankruptcy.

Section 523 of the Code—entitled "Exceptions to Discharge"⁵⁷—reflects the national policy that certain debts should survive the bankruptcy discharge. Most exceptions to discharge are based on wrongful

55. The law of dischargeability (debts excepted from discharge) is found in 11 U.S.C.A. § 523(a) (West 1979). The Bankruptcy Code excludes application of § 523(a) to the Chapter 13 discharge granted when the plan has been fully consummated. *Id.* §§ 523(a), 1328(a). The only exception is family support. *Id.* § 523(a)(5).

Both S. 2266 and H.R. 8200 excluded application of § 523(a) to the completed Chapter 13 plan with a single exception, although the Senate exception was for debt incurred for willful and malicious conversion of or injury to the property or person of another, while that of the House was for family support payments. Neither report explained the reason for this exclusion, which was a significant change from the Bankruptcy Commission proposal. *See* note 62 *infra*.

56. 11 U.S.C.A. § 1328(a) (West 1979) reads:

As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt

(1) provided for under section 1322(b)(5) of this title; or
(2) of the kind specified in section 523(a)(5) of this title.

57. Specifically, the exceptions to discharge set out in § 523(a) may be summarized as follows:

1. *Taxes* Three types of taxes are excepted from discharge: (1) those entitled to priority payment under section 507(a)(2) & (6); (2) those for which a return, if required, has not been filed, or was late-filed within two years of bankruptcy; (3) those arising from a fraudulent return or from willful evasion. 11 U.S.C.A. § 523(a)(1) (West 1979).

2. *Fraud* Obtaining money, property, or services by fraud generally results in a nondischargeable obligation. A particular type of fraud is perpetrated with a false financial statement. *Id.* § 523(a)(2).

3. *Unlisted Liabilities* Claims of creditors who are not listed and who do not have "notice or actual knowledge" of the bankruptcy in time to file a claim are excepted from discharge. *Id.* § 523(a)(3).

4. *Fiduciaries, Embezzlers, and Thieves* Debts incurred through embezzlement or theft are

conduct, but some, such as taxes⁵⁸ and student loans,⁵⁹ are expressions of policy favoring the government, and at least one, unsecured debt,⁶⁰ is essentially a due process provision. Of the types of debt excepted from discharge under Chapters 7 and 11, only spousal or child support obligations⁶¹ survive after completion of a Chapter 13 partial payment plan. Were this the result of a deliberate policy decision by the Congress, it would be remarkable. However, the legislative evolution of sections 523 and 1328(a) and the statutory inconsistencies of section 1328 both internally and with other portions of the Code suggest the contrary.

The Commission Bill expressly made the exceptions to discharge applicable to payment plans.⁶² Though section 1328(a) represents a congressional rejection of the Commission's position on this issue, the legislative history offers no explanation for that decision.⁶³ Moreover, Congress expressly reaffirmed the principle of nondischargeability in other areas of the Code,⁶⁴ making the exceptions to discharge applicable to individuals who receive a discharge in straight bankruptcy and to individuals who obtain the benefits of a discharge through confirmation of a Chapter 11 plan.⁶⁵ Given all these factors, the treatment of section 523 in Chapter 13 defies understanding.

Though the rationale of section 1328(a) is hard to determine, its

excepted from discharge. Also excepted from discharge are debts incurred through a fiduciary's fraud or defalcation. *Id.* § 523(a)(4).

5. *Support* Support obligations to a spouse or child survive discharge. *Id.* § 523(a)(5).

6. *Willful and Malicious Injury* Liabilities for willful and malicious injury to another or to the property of another are nondischargeable. *Id.* § 523(a)(6).

7. *Fines and Penalties* Governmental fines, penalties, and forfeitures are nondischargeable to the extent that they do not represent "compensation for actual pecuniary loss." *Id.* § 523(a)(7).

8. *Education Loans* Student loans are nondischargeable if the money is owed to a non-profit institution of higher education, or is owed to or guaranteed by a governmental unit. *Id.* § 523(a)(8).

58. *Id.* § 523(a)(1); see note 57 *supra*.

59. *Id.* § 523(a)(8); see note 57 *supra*.

60. *Id.* § 523(a)(3); see note 57 *supra*.

61. *Id.* §§ 523(a)(5), 1328(a).

62. See COMM'N REP., *supra* note 2, pt. II, § 6-207, which excepted from the effect of a discharge pursuant to a composition liability of the debtor on claims "specified in section 4-506(a)." Section 4-506(a) was the Commission version of § 523(a) of the Code (exceptions to discharge).

63. See note 55 *supra*.

64. "H.R. 8200 carries over from current law the concept that certain debts should be excepted from discharge. That is, certain debts should continue to be obligations of the debtor after bankruptcy notwithstanding the bankruptcy discharge." HOUSE REP., *supra* note 12, at 129.

"As with current law, certain debts . . . are excepted from discharge." SENATE REP., *supra* note 14, at 6.

65. 11 U.S.C.A. § 1141(d)(2) (West 1979).

practical effect is clear—namely, it creates an anomalous disparity among the forms of bankruptcy relief. Because Congress has failed to distinguish between substantial and nominal partial payment plans under Chapter 13, the exceptions to discharge, with the exception of family support obligations, will be inapplicable to an individual who completes a partial payment plan, regardless of how modest that plan is.⁶⁶ Thus, an individual who completes a confirmed 10 percent plan is entitled under section 1328(a) to discharge taxes, including fines and penalties for tax evasion;⁶⁷ liabilities for fraud; unlisted liabilities; defalcations by fiduciaries, embezzlements and thefts; liabilities for willful and malicious injuries such as battery and malicious mischief; criminal fines; and student loans. None of these liabilities would be discharged had the same individual completed the same plan in Chapter 11⁶⁸ or received a Chapter 7 discharge liquidating similar assets,⁶⁹ and one is hard pressed to reconcile the contradictory treatment.

One is harder pressed to reconcile subsections 1328(a) and 1328(b). The latter subsection provides for the so-called hardship discharge. Its obvious purpose, as well as that of its predecessors in the Commission Bill⁷⁰ and in Chapter XIII of the Bankruptcy Act,⁷¹ is to assist the debtor who fails to complete a confirmed plan for reasons beyond his control. Thus, the debtor who has done his best but falls short of completion nevertheless receives a discharge under this subsection. The section 1328(b) debtor does not, however, escape the section 523 exceptions to discharge.⁷² This is the ultimate irony: the more ambitious the payment plan, the more likely section 523 will apply to the debtor; therefore the more the debtor's debt contracting conduct has been of

66. See notes 55 & 56 *supra*. The § 1328(a) discharge is conditioned only upon completion (consummation) of the plan. The statutory minimum plan is "not less than the amount" creditors would receive if the debtor were in Chapter 7 ordinary bankruptcy. 11 U.S.C.A. § 1325(a)(4) (West 1979). If all of the debtor's property is exempt, a nominal or even zero payment plan is conceivably confirmable under this statutory standard.

67. 11 U.S.C.A. § 523(a)(7) (West 1979). Any taxes entitled to priority, however, must be paid during the Chapter 13 case. Section 1322(a)(2) requires that the plan provide for full payment "of all claims entitled to priority as defined in Section 507." *Id.* § 1322(a)(2). These taxes are entitled to priority under § 507(a)(2) and (6). *Id.* § 507(a)(2) & (6).

68. "The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title." *Id.* § 1141(d)(2).

69. Section 523(a) is by its introductory clause applicable to a discharge "under section 727." *Id.* § 523(a).

70. See COMM'N REP., *supra* note 2, pt. II, § 6-207(a)(2).

71. 11 U.S.C. § 1061 (1976) (repealed 1978).

72. 11 U.S.C.A. § 1328(c) (West 1979) provides that a "discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts . . . except any debt . . . (2) of a kind specified in section 523(a) of this title."

the anti-social variety, such as embezzlement, fraud, or tax evasion, the greater the inducement to low payment plans.

Two threads run through the legislative reports, the significant departures from Chapter XIII of the former Act, and the statutory inconsistencies and incongruities within and without Chapter 13:

(1) An assumption that only debtors who propose to pay creditors in full or in substantial part, and then only if the plan as proposed is a good faith effort to pay creditors the greatest amount that reasonably can be expected, were intended to enjoy the enhanced benefits of Chapter 13.

(2) A conclusion that the draftsmen, through oversight,⁷³ fashioned a statute that contradicts that assumption and, if literally construed, frustrates congressional policy.

V. STATUTORY ACTION

Only Congress is capable of correcting the imbalance created by Chapter 13 while preserving the goals of increasing the use of full and substantial payment plans and maintaining the traditional advantage of partial payment plans.⁷⁴ Relatively minor drafting changes need be considered. It is not necessary, and as a matter of policy it may not be desirable, to make all of the revisions suggested in this Article.⁷⁵ Each part, however, should be reconciled to Chapter 13, to the Code as a whole, and to the objectives of Congress.

A. Creditor Consent

Restoring unsecured creditor participation⁷⁶ in plans is the simplest and surest means of curtailing abuses of Chapter 13. Even if nothing else were changed, the ability of creditors to police the plan and to bargain with the debtor over the amount of partial payment would make Chapter 13 more palatable. Then, if abuse occurred, responsibility would be due in part to the creditors' acquiescence or inaction.

73. "[I]t would appear almost preposterous to suppose that Congress intended Chapter 13 to be such an easy escape valve from Chapter 7" Neustadter, *Consumer Insolvency Counseling for Californians in the 1980's*, 19 SANTA CLARA L. REV. 817, 911 (1979).

74. Two bills amending Chapter 13 provisions are before the 96th Congress: S. 658, 96th Cong., 1st Sess. (1979) and H.R. 5447, 96th Cong., 1st Sess. (1979).

75. For example, restoration of creditor approval of plans, although a means of preventing abuse, may not be necessary if other changes are made.

76. See notes 26 & 43 *supra*.

None of the reasons given for denying creditor participation in acceptance or rejection of a Chapter 13 plan is persuasive.⁷⁷ That creditors have seldom voted against plans in the past hardly justifies withholding that power in the future; the likelihood that creditors will reject inadequate partial payment plans is an argument in favor of that power, not against it. Furthermore, withholding creditor participation in Chapter 13 plans while permitting, even encouraging, their participation in Chapter 11⁷⁸ cannot be reconciled.

B. Substantial Payment Plans

A statutory confirmation standard for substantial partial payment plans is highly desirable. The present standard for the minimum amount of payment—not less than what creditors would receive in Chapter 7⁷⁹—would be adequate to prevent abuse provided the debtor is subject to the same disabilities as in Chapter 7. This, however, would not satisfy the policy decision of the Bankruptcy Commission and of the Congress to encourage substantial payment plans by making partial payment plans more attractive. To meet this objective, it is necessary to remove some or all of the disabilities in exchange for payments in excess of the liquidating distribution standard.

A logical standard for confirmation of future payment plans is the existing two-part test for discharge in Chapter 7 following too closely on a confirmed composition plan: (1) payment of 70 percent of al-

77. The Commission reported that partial payment plans were unpopular because "a proposal therefor is likely to entail objections from creditors to the plan." COMM'N REP., *supra* note 2, pt. I at 161. It also noted that in those few districts that have had success with the use of partial payment plans "unsecured creditors do not often object to proposed plans of composition, [which] is not surprising in view of the fact that ordinarily the alternative is for the debtor to file a petition in bankruptcy" *Id.* at 162. The Commission therefore concluded that the "requirement of consent by a majority of creditors" to a plan "does not appear to the Commission to be a sufficient safeguard of their interests to warrant its retention" *Id.*

The Senate's view of the former Chapter XIII was that "formal creditor voting by literally counting written acceptances has unnecessarily imposed substantial expense for time, paper and uncertainty upon all concerned with only doubtful or marginal benefits." SENATE REP., *supra* note 14, at 13.

The House opinion was that, "[u]nder the present law, the consent requirement often prevents a debtor from making a legitimate offer of less than full payment, for fear that the offer will not obtain the requisite consents." HOUSE REP., *supra* note 12, at 123. The House Report also stated that "[c]reditors will not be disadvantaged, because the plan must still pay them more than they would get under a liquidation." *Id.* at 124.

78. 11 U.S.C.A. § 1129(a)(8) (West 1979) conditions confirmation on acceptance of the plan. Acceptance is defined at *id.* § 1126. Solicitation of acceptance is governed by *id.* § 1125. The disclosure section, designed to enable "all creditors and stockholders whose rights are to be affected . . . [to] be able to make an informed judgment of their own" on acceptance or rejection of the plan, has been described as the key to Chapter 11. HOUSE REP., *supra* note 12, at 226.

79. 11 U.S.C.A. § 1325(a)(4) (West 1979).

lowed unsecured claims and (2) the debtor's best effort.⁸⁰ This has the advantages of simplicity and symmetry, and presumably represents a resolution by Congress of similar competing policy considerations. But the standard also could be one or the other of the above requirements, and a percentage test could be higher or lower. Furthermore, there might be alternative tests depending on the extent of trade-offs. These trade-offs, the disabilities associated with ordinary bankruptcy, involve the grounds for denying discharge and debts excepted from discharge.

C. *Grounds for Denying Discharge*

The several separate grounds for withholding discharge⁸¹ derive from varying policy considerations and are best viewed in light of these considerations. In particular, the ground designed to discourage overuse of bankruptcy—the six-year bar⁸²—must be set apart from the others, most of which punish wrongful conduct.

All the grounds for denying discharge should apply to bar confirmation of a plan that pays creditors no more than they could be paid under Chapter 7, or any plan that proposes only nominal payment in excess of liquidation value. On the other hand, abandonment of grounds for denying discharge as a condition of confirmation of a full payment plan is consistent with the objectives of encouraging greater use of Chapter 13. It is difficult to imagine any potential for abuse in this event, particularly if creditors have the right to vote on a plan. If the plan proposes less than full payment but meets the substantial payment standard, removing the ground for denying discharge based on overuse of the bankruptcy system⁸³ would promote the use of Chapter 13 without subjecting it to abuse. The same cannot be said for the other grounds for denying discharge in ordinary bankruptcy. Abandonment of these other grounds as a condition of confirmation of a plan proposing less than full payment cannot be justified.⁸⁴

80. *Id.* § 727(a)(9); see note 54 and accompanying text *supra*.

81. 11 U.S.C.A. § 727(a) (West 1979).

82. *Id.* § 727(a)(8) & (9).

83. *Id.* It should be noted that the potential for abuse of Chapter 13 plans that do not require substantial payment is not limited to prior ordinary bankruptcy discharges within six years. A potential for abuse also exists with respect to repeated nominal payment plans. Section 1325(a) permits confirmation of a series of good faith nominal partial payment plans without time limitations. See *id.* § 1325(a).

84. Reasons given for departing from this condition to confirmation of a partial payment plan are unpersuasive. See note 45 *supra*.

The Commission pointed out that it was an "inappropriate limitation on the court's ability to

In summary, Congress can reduce the potential for abuse of Chapter 13 while still encouraging its greater use by conditioning confirmation of all partial payment plans on the absence of circumstances that would bar discharge under Chapter 7, providing only that the six-year bar would not apply if a standard of substantial payment is met.

D. Exceptions to Discharge

Any discrepancies in dischargeability⁸⁵ standards encourage use of partial payment plans as an alternative to Chapter 7 bankruptcy, but one must ask whether the benefit is worth the price. A more important question that transcends Chapter 13 is whether individuals who receive discharges in bankruptcy should nevertheless remain liable for certain types of debt. Both the Commission and the Congress answered the latter question in the affirmative,⁸⁶ and no basis for answering the question one way for bankruptcy and another way for payment plans comes to mind. Indeed, the Code makes no distinction between Chapter 7 and Chapter 11⁸⁷ for individuals, and the draftsmen have not told us why Chapter 13 should be different.⁸⁸ At the very least, a Chapter 13 exception to the dischargeability rules should be limited to substantial payment, best effort plans.

In summary, a statutory program designed to curb the present potential for abuse could be based on the following principles:

- (1) Creditor approval of all partial payment plans; possible relaxation of this requirement if other changes are made;
- (2) A substantial payment standard to supplement the minimum payment standard of section 1325(a)(4);
- (3) Confirmation of *full* payment plans without regard to any of the section 727(a) discharge standards;
- (4) Confirmation of *substantial* partial payment plans despite a prior bankruptcy or composition within six years but otherwise subject to the section 727(a) standards;

confirm a plan," COMM'N REP., *supra* note 2, pt. I at 163, and that "neither the interests of the creditors nor the principles of sound bankruptcy administration require a denial of confirmation due to conduct on the part of the debtor which would bar a discharge." *Id.* at 175. The Commission thought that there were sufficient safeguards, including creditor consent and "greater incentive for the debtor to perform." *Id.* Neither the Commission bill nor the Code permit creditor voting on the plans, however. See text accompanying notes 25 & 42 *supra*.

85. See text accompanying notes 29 & 55-72 *supra*.

86. See notes 55, 68 & 69 *supra*.

87. See notes 68 & 69 *supra*.

88. See note 63 *supra*.

(5) Confirmation of *minimum* payment plans subject to all section 727(a) discharge standards;

(6) Consistent application of the section 523(a) exceptions to discharge to individual debtors, whether the case be filed under Chapters 7, 11 or 13.

Adoption of these principles would encourage greater use of both full and substantial payment plans while preserving the advantages of former Chapter XIII. Most importantly, minimum payment plans would permit debtors to avoid nothing more than liquidation of non-exempt assets. Whether Congress will make any of the foregoing changes remains to be seen.⁸⁹ Unless and until Congress acts, however, any solution of the problem is left to the courts.

VI. JUDICIAL REACTION

In the absence of legislative revisions, can the courts help Chapter 13 achieve the declared goals of the Congress? It is still too early to know the answer, but if they fail it will not be for lack of trying. Thus far, no single problem has attracted as much attention under the Code, and judges have been turning out a host of decisions in an attempt to find a solution.⁹⁰

The threshold question is whether the statute leaves any room for judicial intervention on either legal or equitable grounds. Arguably, a bankruptcy court's equity power is sufficient to control any potential abuse of Chapter 13.⁹¹ In appropriate cases, a court might decline confirmation of a plan that fails to meet a reasonable standard,⁹² withhold a section 1328(a) discharge, or apply section 523(a) nondischargeability standards to the section 1328(a) discharge. Bankruptcy courts are frequently admonished, however, that they are not free to fashion equitable principles contrary to statutory provisions.⁹³ Any judicial tinkering

89. See note 74 *supra*.

90. See cases cited note 92 *infra*.

91. "Yet we do not read these statutory words with the ease of a computer. There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Bank of Marin v. England*, 385 U.S. 99, 103 (1966).

92. The first reported cases evidence a strong leaning in this direction. One judge refused confirmation of a nominal payment plan as not "reasonable." *In re Fonnest*, 5 B.C.D. 1236 (N.D. Cal. 1980). See also *In re Iacovoni*, 5 B.C.D. 1270, 1277 (D. Utah 1980), wherein the court imposed a "flexible, equitable standard" of "meaningful repayment," and *In re Beaver*, 5 B.C.D. 1285, 1287 (S.D. Cal. 1980), in which a "meaningful" plan that accorded "fundamental fairness" to creditors was required. The latter two cases rest both on equitable principles and a construction of "good faith" in 11 U.S.C.A. § 1325(a)(3) (West 1979).

93. "A bankruptcy court is a court of equity . . . and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act." *SEC v. United States Realty &*

with Chapter 13 must, therefore, be justified by the usual principles of statutory construction.

If "the function of a court when dealing with a statute is to ascertain and effectuate the intention of the legislature,"⁹⁴ the response of the courts to Chapter 13's potential for abuse should first be to ascertain Congressional intent and then, if possible, to effectuate it. Ascertainment of intent is sometimes thought to be limited to the statutory language, particularly if the words are free from doubt. Thus, the "plain meaning" rule is said to confine the courts to a literal reading of the statute in the absence of ambiguity.⁹⁵ If a strict adherence to this rule is required, the courts no doubt are helpless to intervene in Chapter 13 because few of its pertinent provisions are fraught with ambiguity. In particular, the confirmation standards in section 1325(a) and the words "shall confirm" have a plain, unambiguous meaning. Any adjustment of those standards would therefore violate the "plain meaning" rule.

The Supreme Court, however, has never demanded strict adherence to the "plain meaning" rule. Instead, the Court has consistently declined to apply the rule if it would lead to absurd or wholly impractical consequences.⁹⁶ Beyond that, the Court has cast serious doubt on the present validity of any rule that forbids resort to legislative history, "however clear the words may appear on 'superficial examination.'"⁹⁷ A literal reading is rejected if it "would bring about an end completely at variance with the purpose of the statute,"⁹⁸ or would lead to injustice,⁹⁹ or "to extreme or absurd results."¹⁰⁰ Furthermore, "even when the plain meaning does not produce absurd results but merely an *unreasonable* one 'plainly at variance with the policy of the legislation as a whole,' [the] Court has followed that purpose, rather than the literal

Improvement Co., 310 U.S. 434, 455 (1940). See also *In re Chanticleer Assocs., Ltd.*, 592 F.2d 70 (2d Cir. 1979); *Knox v. Lines*, 463 F.2d 561, 563 (9th Cir. 1972); *In re Dade County Dairies, Inc.*, 474 F. Supp. 438, 440 (S.D. Fla. 1979). In *Chanticleer*, the court stated that equitable powers of the bankruptcy court are limited and must not be inconsistent with the provisions of the Act.

94. Murphy, *Old Maxims Never Die: The "Plain-Meaning Rule" and Statutory Interpretation in the "Modern" Federal Courts*, 75 COLUM. L. REV. 1299 (1975).

95. See *United States v. Missouri Pac. R.R.*, 278 U.S. 269 (1929); *Caminetti v. United States*, 242 U.S. 470 (1917).

96. *United States v. Missouri Pac. R.R.*, 278 U.S. 269, 278 (1929); *Caminetti v. United States*, 242 U.S. 470, 490 (1917).

97. *Train v. Colorado Pub. Interest Research Group*, 426 U.S. 1, 10 (1976); *United States v. American Trucking Ass'n's*, 310 U.S. 534, 543-44 (1940). See generally Murphy, *supra* note 94.

98. *United States v. Public Utils. Comm'n*, 345 U.S. 295, 315 (1953).

99. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819).

100. *United States v. Katz*, 271 U.S. 354, 362 (1926).

words.”¹⁰¹ Rejecting the “tyranny of literalness,” the Supreme Court has looked to the statute “as a whole” to give a “restrictive meaning for what appear to be plain words.”¹⁰² Even when the result is merely “eccentric,” it has been held error to treat a section “simply as a text to be parsed with such aid as the dictionary and grammar afford and without adequately considering the history of the statute and the evil it was designed to cure.”¹⁰³

The Court's willingness to depart from “plain” statutory language in appropriate circumstances is evident in its interpretation of the now repealed Chapter XIII. In *Perry v. Commerce Loan Co.*,¹⁰⁴ the Court was asked to decide whether an extension plan could be confirmed, even though the debtor had obtained a straight bankruptcy discharge within the preceding six years. Section 14(c)(5) of the Bankruptcy Act, on its face, barred confirmation of the plan. Nevertheless, the Court held that section 14(c)(5) did not bar confirmation of an extension plan. The Court wrote that “[e]ven if a literal reading of these provisions suggested the application of § 14(c)(5) to extension plans, we would have little hesitation in construing the Act to give effect to the clear policy underlying Chapter XIII.”¹⁰⁵ That policy—that “Congress clearly intended to encourage wage earners to pay their debts in full, rather than to go into straight bankruptcy or composition”¹⁰⁶—was ascertained through recourse to the legislative history of the Act.¹⁰⁷

Ascertaining congressional intent therefore should not necessarily be accomplished simply by examining the words of Chapter 13, plain as their meaning may appear. In addition to the literal language of the statute, the courts must consider Chapter 13's relationship to the Bankruptcy Code as a whole, as well as the interaction of its various provisions, giving rational meaning to all parts. The courts must also consider the legislative history of the Code in ascertaining the congressional intent underlying Chapter 13.

The courts may conclude that a literal reading of Chapter 13, which permits nominal or no-payment plans, deprives Chapter 7 of any purpose. They may also be persuaded that such a reading renders the

101. *United States v. American Trucking Ass'ns*, 310 U.S. 534, 544 (1940) (quoting *O Ozawa v. United States*, 260 U.S. 178, 194 (1922)) (emphasis added).

102. *United States v. Witkovich*, 353 U.S. 194, 199 (1957).

103. *National Resources Defense Council, Inc. v. TVA*, 459 F.2d 255, 257 (2d Cir. 1972).

104. 383 U.S. 392 (1966).

105. *Id.* at 399-400.

106. *Id.* at 395.

107. *Id.* at 395-97, 399-401.

distinction between discharges under sections 1328(a) and (b) absurd. Having studied the reports of the Bankruptcy Commission and of the House and Senate, the courts may ascertain that Congress intended to encourage substantial, as well as full, payment plans under Chapter 13. In short, the courts may well determine that a literal reading of Chapter 13 frustrates rather than furthers congressional policy and statutory purpose.

To ascertain that broad policy and purpose is one thing; to effectuate it is another. Chapter 13 is a complex statutory scheme, and the courts, by tinkering with one or more of its parts in an attempt to further general congressional intent, could do more harm than good. Nevertheless, there are some avenues that the courts may take to further the congressional intent behind Chapter 13.

The most promising vein for judicial prospecting would appear to be section 1325(a)—the conditions for confirmation of Chapter 13 plans. This is the section the Senate would amend “so that the liberal provisions allowing composition plans in Chapter 13 will not be abused by debtors.”¹⁰⁸ This is also the section that has been examined to date by most of the courts that have refused to read Chapter 13 literally.¹⁰⁹ Most have imposed a substantial or meaningful payment standard or best effort test as a condition of confirmation by reading “good faith” in section 1325(a)(3) expansively.¹¹⁰ For example, in *In re Beaver*,¹¹¹ the debtor, whose assets were all exempt, proposed a Chapter 13 plan that would have paid one percent of her indebtedness, with total payments of \$32.06. The bankruptcy court refused to confirm the plan, on grounds that the good faith requirement of section 1325(a)(3) had not been satisfied. “[Congress] anticipated that use of this Chapter would be restricted to those who propose legitimate plans,” the court wrote,

108. S. 658, 96th Cong., 1st Sess. § 188 (1979), would amend 11 U.S.C.A. § 1325(a)(3) (West 1979) to require the debtor's best effort for confirmation of a plan. This is explained in S. REP. No. 96-305 accompanying S. 658:

This amendment makes a change to section 1325(a)(3) so that it is clear that the court should determine that the payments in the plan proposed by the debtor are the greatest that the debtor can reasonably pay so that the liberal provisions allowing composition plans in chapter 13 will not be abused by debtors. It conforms to the standard of section 727(a)(9) relating to the bar to discharge.

(Emphasis added).

109. An unknown but substantial number of judges have read 11 U.S.C.A. § 1325(a) (West 1979) literally and have confirmed nominal payment plans. None of those cases, however, has been reported to date.

110. See, e.g., *In re Beaver*, 5 B.C.D. 1285 (S.D. Cal. 1980); *In re Iacovoni*, 5 B.C.D. 1270 (D. Utah 1980); *In re Powell*, 5 B.C.D. 1233 (E.D. Va. 1980); *In re Curtis*, 5 B.C.D. 1214 (W.D. Mo. 1979).

111. 5 B.C.D. 1285 (S.D. Cal. 1980).

"and this intention is embodied in the requirement of good faith."¹¹²

In addition to the good faith requirement of section 1325(a)(3), there is another approach to effectuating the congressional intent behind Chapter 13. Congress established a standard for encouraging substantial payment in section 727(a)(9) of the Code. Under this standard, a debtor who completes a partial payment plan may obtain a Chapter 7 discharge within the next six years, provided that over 70 percent of creditors' claims were paid under the plan and that the plan represented the debtor's best effort. Arguably, this standard could be engrafted onto section 1325 as an implied condition of confirmation with or without consideration of the good faith requirement of section 1325(a).¹¹³

For the courts to do what they think the legislature would or should have done is a risky undertaking.¹¹⁴ The degree of intervention outlined, however, while constituting a quantum leap in effectuating legislative intent, is relatively narrow because it is based either on a legislative solution to an analogous problem¹¹⁵ or on a proposed legislative solution to this very problem.¹¹⁶ The suggested intervention is far from being a complete answer,¹¹⁷ but it serves to harmonize and rationalize the Bankruptcy Code until Congress acts, and it does minimize Chapter 13's potential for abuse.

112. *Id.* at 1287.

113. This approach was taken by the author in *In re Burrell*, 5 B.C.D. 1321 (N.D. Cal. 1980). The *Burrell* decision is now on appeal to the district court.

114. "When a judge tries to find out what the government would have intended which it did not say, he puts into its mouth things which he thinks it ought to have said, and that is very close to substituting what he himself thinks right. Let him beware, however, or he will usurp the office of government, even though in a small way he must do so in order to execute its real commands at all." Hand, *How Far is a Judge Free in Rendering a Decision?*, in *THE SPIRIT OF LIBERTY* 108 (3d ed. 1960).

115. 11 U.S.C.A. § 727(a)(9) (West 1979).

116. See note 108 *supra*.

117. There are two serious problems with the second proposed solution. First, reading the § 727(a)(9) standard into § 1325(a) makes Chapter 13 of the Code more restrictive than Chapter XIII under the former Act because it eliminates the confirmation of some plans that are designed to preserve nonexempt assets by paying their value out of future earnings. See note 12 and accompanying text *supra*. Second, there is no assurance that Congress would have chosen this solution.

